Islamic Preference Shares: An Analysis in light of the Principles of Musharakah and Tanazul

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Abstract

A preference share is among hybrid instruments that combine equity and debt in a capital market. It is in the form of hybrid equity which allows its holder to receive a fixed dividend that is not enjoyed by ordinary shareholders. Usually, this fixed dividend is described as a percentage of the nominal share value. The holders of the preference shares are treated in preference or priority over the ordinary shareholders in the following ways:

a) Fixed dividend before any dividend is paid to common shareholders;

b) Rank ahead of common shareholders in the return of capital should the company face an event of defaults such as liquidation.

c) These shares are convertible to a certain number of shares of the company’s common shares at an agreed predetermined conversion rate, after a predetermined time span or a fixed future date. However the shares cannot be redeemed via cash on the maturity date.

d) Generally no voting rights in the general meeting except in matters affecting their right as preference shareholders.

In light of this conventional practice, the Islamic preference shares are issued based on the Shari'ah principle of Musharakah. It is agreed by the common shareholders that the Islamic preference share will be ranked ahead of the common share in terms of priority to dividend payment up to the expected dividend and in terms of the return of capital in the event of liquidation. The priority given to the Islamic preference share holders is based on the principle of Tanazul (waiving of right). This paper examines how these two principles are executed in the above transaction and how far they are accepted and practiced in Islamic financial institutions.
Introduction: Preference Share

Preference share, also called preferred stock or preferred share, is typically a ‘higher ranking’ share than common share, and its terms are negotiated between the corporation and the investor. These shares are corporate fixed-income securities that the investor can choose to turn into a certain number of shares of the company’s common share after a predetermined time span or on a specific date. The fixed-income component offers a steady income stream and some protection of the investors’ capital. But the option to convert these securities into share gives the investor the opportunity to gain from a rise in share price.

Convertibles are particularly attractive to those investors who want to participate in the rise of hot growth companies while being insulated from a drop in price should the stocks not live up to expectations. To demonstrate how convertible preferred shares work and how they benefit investors, let’s consider an example:

Let’s say ABC company issues one million convertible preference shares priced at RM100 a share. These convertible preference shares (as they are fixed-income securities) give their holders priority over common shareholders in two ways. First, convertible preferred shareholders receive a 4.75% dividend (provided ABC’s earnings continue to be sufficient) before any dividend is paid to common shareholders. Second, convertible-preference shareholders will rank ahead of common shareholders in the return of capital if ABC ever went bankrupt and its assets had to be sold off.

By buying ABC convertible preference shares, the worst investors would ever do is receive a RM4.50 annual dividend for each share they own. But these securities offer their owners the possibility of even higher returns: if the convertible preference shareholders see a rise in ABC’s stock, they may have the opportunity to profit from that rise by turning their fixed-income investment into equity. On the reset date shareholders of ABC convertible preference shares have the option of converting some or all of their preference shares to common share.

Unlike common share, preference share usually has several rights attached to it:

- The core right is that of preference in the payment of dividends and upon liquidation of the company. Before a dividend can be declared on the common shares, any dividend obligation to the preferred shares must be satisfied.
- The dividend rights are often cumulative, such that if the dividend is not paid it accumulates from year to year.
- Preference share may or may not have a fixed liquidation value, or par value, associated with it. This represents the amount of capital that was contributed to the corporation when the shares were first issued.
- Preference share has a claim on liquidation proceeds of a share corporation, equivalent to its par or liquidation value unless otherwise negotiated. This claim is senior to that of common share, which has only a residual claim.

1 http://en.wikipedia.org/wiki/Preferred_stock
2 http://www.investopedia.com/articles/stocks/05/052705.asp
3 Ibid.
Almost all preference shares have a negotiated fixed dividend amount. The dividend is usually specified as a percentage of the par value or as a fixed amount. Sometimes, dividends on preference shares may be negotiated as floating i.e. may change according to a benchmark interest rate index such as LIBOR.

Some preference shares have special voting rights to approve certain extraordinary events (such as the issuance of new shares or the approval of the acquisition of the company) or to elect directors, but most preference shares provide no voting rights associated with them. Some preference shares only gain voting rights when the preference dividends are in arrears for a substantial time.

Usually preference shares contain protective provisions which prevent the issuance of new preference shares with a senior claim. Individual series of preference shares may have a senior, pari-passu or junior relationship with other series issued by the same corporation.

Occasionally companies use preference shares as means of preventing hostile takeovers, creating preference shares with a poison pill or forced exchange/convertible features that exercise upon a change in control.

The above list, although including several customary rights, is far from comprehensive. Preference shares, like other legal arrangements, may specify nearly any right conceivable. Some corporations contain provisions in their charters authorizing the issuance of preferred stock whose terms and conditions may be determined by the board of directors when issued. These "blank check" preferred shares are often used as takeover defense. These shares may be assigned very high liquidation value that must be redeemed in the event of a change of control or may have enormous super voting powers.4

In Malaysia, preference share is defined by the Company Act 1965 as a share that does not give right to the shareholders to votes at its general meeting or any right to participate in any distribution of the company that is above the stated amount, whether through dividends or redemption, dissolution or otherwise.5

Islamic Preference Share

In light of the conventional practice above, the Islamic preference shares are issued based on the Shari‘ah principle of Musharakah. It is agreed by the common shareholders that the Islamic preference share will be ranked ahead of the common share in terms of priority to dividend payment up to the expected dividend and in terms of the return of capital in the event of liquidation. The payment of dividends however, is not fixed and guaranteed. It shall only be payable subject to the availability of distributable profits.

Shari‘ah Advisory Council (SAC) of Securities Commission (SC) at its 20th meeting on 14 July 1999 resolved that the basic preference share (non-cumulative) is permissible based on tanazul.

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The SAC carried out studies on non-cumulative preference shares. It refers to preference shares whose period of holding by the investor is permanent and similar to ordinary shares except that dividends are fixed and non-cumulative. It has features similar to those of an ordinary share – no maturity date and non-cumulative dividend payment. Non-cumulative preference shares are included in the classification of equity with fixed dividends.\(^6\)

Arguments that support the permissibility of the preference shares: The SAC ruled that non-cumulative preference shares are permissible based on *tanazul* where the right to profit of the ordinary shareholder is willingly given to a preference shareholder. *Tanazul* is agreed upon at an annual general meeting of a company which decides to issue preference shares in an effort to raise new capital. As it is agreed at the meeting to issue preference shares, this means that ordinary shareholders have also agreed to give priority to preference shareholders in dividing the profits, in accordance with *tanazul*. In the context of preference shares, *tanazul* means surrendering the rights to a share of the profits based on partnership, by giving priority to preference shareholders. It is also known as *isqat haq* in Islamic jurisprudence.\(^7\)

Nevertheless, it is appropriate to mention here that to the best of the researcher’s knowledge, only the resolution given by SAC of Securities Commission (SC), Malaysia allows the preference share. The other bodies that are responsible to issue fatwa or Shari’ah resolution for Islamic financial Institutions such as AAOIFI and the Fiqh Academy do not allow such transaction. Their resolutions can be found as follows:

1. The International Council of Fiqh Academy, which is an offshoot of the Organization of Islamic Conferences (OIC), in its 14\(^{th}\) session in Doha, Qatar, which was held from 8 – 13 of Dhulqadah, which corresponds to 11 – 16 January 2003, after reviewing the research papers that were presented to the Council regarding the issue of modern companies: holding companies and others, and the relevant Shari’ah rulings, and after listening to the discussions that revolved around it, resolved the following:

   1. The definition of modern companies:
      a. Capital companies: These are companies where their establishment and formation is dependent on the capital of the partners, regardless of the independent legal personalities of each shareholder. Furthermore, the shares of each shareholder are negotiable. Capital companies are divided into:
         i. Shareholding Company: It is a company in which the capital is divided into equal shares that are negotiable. Every shareholder in it (the company) is only responsible for his share of the capital;
         ii. Stock broking recommended company: It is a company where their capital is formed from negotiable shares. In this type of company, there are two types of partners, i.e. partners with joint liability (jointly responsible for the debts of the company) and partners with limited liability, i.e. their liability is limited to the proportion of their shares; and

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\(^7\) Ibid.
iii. Company with limited liability: It is a company where the capital is owned by a specific number of partners, where the maximum number of partners is fixed (this is normally different from one jurisdiction to another), the liability of the partners is limited by amount of shares owned by each of them and the shares (allocated) are non-negotiable.

b. Partnership companies: It is a company where its existence is based on individuals who are partners in it, where each of them has a separate legal personality. In addition, the partners know one another and each among them reposes trust in another. It is divided into two:
   i. Joint Partnership Company: It is a company that is formed by two or more people, with an intention to conduct a business. It is formulated on the basis that each party will contribute towards the capital. They are personally and jointly liable in respect of the debts of the company. This type of company is primarily based on the partners’ personal knowledge of each other (in terms of knowledge, skills, experience and temperament); and
   ii. Limited Partnership Corporation: It is a company that is formed between two or more individuals, who are jointly liable or between two or more individuals who are not part of the management team (they are called limited partners and their liability is only limited to the amount of their stakes in the partnership's capital).

c. Mahas holding company: It is a company which is veiled from others (not an entity that is publicized to the general public), and do not enjoy a legal personality. It is formed between two or more persons, with each of them holding a stake of the capital. In this type of company, the partners agree to share profits and losses from one or more commercial ventures undertaken by them or one of the partners. If the venture is performed by only one of the partners, the liability is limited to the said partner;

d. Holding company: It is a company that holds a controlling stake of a company or group companies; and

e. Multinational company: It is a company that is composed of groups of branch companies, with a headquarters in one of the countries. In terms of its legal entity, the company is a resident company in the country where the headquarters is located. Although far apart from each other, the headquarters will work together with its branches to actualize particular investment goals;

2. The original presumption of companies is permissibility, provided its activities are free from elements prohibited by the Shari’ah. However, if the core activity of the company is haram (non-permissible), then the company itself is haram. Examples are banks that deal with interest and companies that deal with prohibited products (e.g. drugs and pigs). In this case, it is not permissible to own or trade the shares of the said companies. Similarly, it is compulsory for a company to be free from uncertainties and ignorance,
which lead to disputes, as well as anything that will render the company void in the eyes of the Allah;

3. **It is not permissible for a company to issue shares enjoyed or preference shares or debentures;**

4. **In occasions where the company suffers losses, it is compulsory for every shareholder to bear his share of the loss, in proportion to his capital contribution;**

5. Although each shareholder’s stake is in proportion to his capital contribution, in terms of the ownership of the company’s assets, the shareholders have undivided shares of it. With regard to the ownership of the shares, it will remain with the shareholder(s) until it is transferred to another party; and

6. Regarding the method of obtaining zakah (alms) from the shares of the shareholders in holding companies and multinational companies, the Council refers to resolution no. 28 (4/3), in its 4th session and resolution no. 120 (13/3), in its 13th session. 

2. **Shari‘ah Standard No. (12) of Accounting and Auditing Organization for Islamic Financial Institutional (AAOIFI):**

   4/1/2/14 It is not permitted to issue preference shares, i.e. shares that have special financial characteristics that give them a priority at the date of liquidation of the company or at the date of distribution of profit. However, is permissible to grant certain shares, in addition to being entitled to rights attached to common shares, certain procedural and administrative privileges, such as a right of vote.

   Thus, this paper attempts to analyze the resolution given by SC since it is the only resolution which allows preference share. To do so, there are three main Shari‘ah issues in the preference share that need further study, namely:

   a. Priority in certain expected dividend payment is given to preference shareholders over common shareholders

   b. Priority in the return of capital in the event of liquidation is given to preference shareholders over common shareholders.

   c. The priority given is based on tanazul which is agreed upon at an annual general meeting of a company

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8 [http://isra.my/](http://isra.my/)

Since the Islamic preference shares are issued based on the Shari‘ah principle of Musharakah and the priority given is based on the principle of tanazul, these three main Shari‘ah issues should be discussed and elaborated further in light of these two principles.

**Musharakah**

*Musharakah* is a relationship established by the parties through a mutual contract. Therefore, it goes without saying that all the necessary elements of a valid contract must be present here also. For example, the parties should be capable of entering into a contract; the contract must take place with free consent of the parties without any duress, fraud or misrepresentation, etc.

Nevertheless, there are certain elements which are peculiar to this contract. Among others, they are as follows:\(^\text{10}\):

a) Distribution of profit

b) Ratio of profit

c) Sharing of loss

**Distribution of profit**

The proportion of profit to be distributed between the partners must be agreed upon at the time of affecting the contract. If no such proportion has been determined, the contract is not valid in Shari‘ah.

The ratio of profit for each partner must be determined in proportion to the actual profit accrued to the business, and not in proportion to the capital invested by him. It is not allowed to fix a lump sum amount for anyone of the partners, or any rate of profit tied up with his investment.\(^\text{11}\)

To get a clear picture, let’s consider an example: Let’s say Salim and Zaki enter into a partnership and it is agreed between them that Salim shall be given RM50,000 per month as his share in the profit, and the rest will go to Zaki, the partnership is invalid. Similarly, if it is agreed between them that Salim will get 20% of his investment, the contract is not valid. The right basis for distribution would be an agreed percentage of the actual profit accrued to the business.

If a lump sum amount or a certain percentage of the investment has been agreed for anyone of the partners, it must be expressly mentioned in the agreement that it will be subject to the final settlement at the end of the term, meaning thereby that any amount so drawn by any partner shall be treated as ‘on account payment’ and will be adjusted to the actual profit he may deserve at the

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\(^{10}\) Usmani, Muhammad Taqi. *An Introduction to Islamic Finance*. Karachi: Maktaba Ma’ariful Qur’an, 2007, p.35

\(^{11}\) Ibid.
end of the term. But if no profit is actually earned or is less than anticipated, the amount drawn by the partner shall have to be returned.\textsuperscript{12}

**Ratio of profit**

With regard to the ratio of profit vis-à-vis the ratio of capital, there is a difference of opinion among the Muslim jurists:

a) The view of Imam Malik and Imam Shafi’i: It is necessary for the validity of musharakah that each partner gets the profit exactly in the proportion of his investment. Therefore, if A has invested 60\% of the total capital, he must get 60\% of the profit. Any agreement to the contrary which makes him entitled to get more or less than 60\% will render the musharakah invalid in Shari’ah.\textsuperscript{13}

b) The view of Imam Ahmad: His view is opposite of what has been stated by Imam Malik and Imam Shafi’i. According to him, the ratio of profit may differ from the ratio of investment if it is agreed between the partners with their free consent. Therefore, it is permissible that a partner with 30\% of investment gets 50\% or 60\% of the profit, while the partner with 70\% of investment gets only 50\% or 40\% of the profit.

c) The view of Imam Abu Hanifah: His view is considered a middle course between the two previous views. According to him, the ratio of profit may differ from the ratio of investment in normal conditions. However, if a partner has put an express condition in the agreement that he will never work for the musharakah and will remain a sleeping partner throughout the term of musharakah, then his share of profit cannot be more than the ratio of his investment.\textsuperscript{14}

**Sharing of loss**

In the case of loss, all the Muslim jurists are unanimous on the point that each partner shall suffer the loss exactly according to the ratio of his investment. Therefore, if a partner has invested 30\% of the capital, he must suffer 30\% of the loss, not more, not less and any condition to the contrary shall render the contract invalid. There is a complete consensus of jurists on this principle.\textsuperscript{15}

Therefore, according to Imam Malik and Imam Shafi’i, the ratio of the share of a partner in profit and loss both must conform to the ratio of his investment. But according to Imam Abu Hanifah and Imam Ahmad, the ratio of the profit may differ from the ratio of investment according to the agreement of the partners, but the loss must be divided between them exactly in accordance with

\textsuperscript{12} Ibid.
\textsuperscript{15} Ibn Qudamah.v.5,p.147.
the ratio of capital invested by each one of them. It is this principle that has been mentioned in the famous maxim:

الربح على ما اصطلاحا عليه والوضيعة على قدر المال

Profit is based on the agreement of the parties, but loss is always subject to the ratio of investment.  

Quite similar rulings can be found in Shari’ah Standards of Accounting and Auditing Organization for Islamic Financial Institutional (AAOIFI). The rulings on the matter are stipulated as follows:

1. The sharika contract should incorporate a provision specifying the manner of sharing profits between the parties. The allocation of profits must be made in a manner that gives each partner an undivided percentage of profit, not a sum of money or a percentage of the capital.

2. It is not permitted to defer the determination of the profit percentages due to each partner until the realization of profit. The profit percentage for each partner must be determined at the conclusion of sharika contract. The parties may bilaterally agree to amend the percentages of profit-sharing on the date of distribution. Also, a partner may relinquish, on the date of distribution, a part of the profit that is due to him in favour of another party.

3. In principle, the shares of profit must be in proportion to the percentage of each partner’s contribution to the sharika capital. Nevertheless, the partners may agree to make profit-sharing not proportionate to their contributions to capital, provided the additional percentage of profit over the percentage of contribution to the capital is not in favour of a sleeping partner. If a partner did not stipulate a condition that he be a sleeping partner, then he is entitled to stipulate an additional profit share over his percentage of contribution to the capital even if he did not work.

4. It is a requirement that the proportions of losses borne by partners be commensurate with the proportions of their contributions to the sharika capital. It is not permitted, therefore, to agree on holding one partner or a group of partners liable for the entire loss or liable for a percentage of loss that does not match their share of ownership in the partnership. It is, however, valid that one partner takes, without any prior condition, the responsibility of bearing the loss at the time of the loss.

Musharakah Analysis

16 Usmani, Muhammad Taqi. p.38
17 Shari’a Standards. p 204.
In light of the above discussion, now we are able to analyze two main Shari’ah issues as mentioned above since they are closely related to *musharakah*, namely:

a. Priority in certain expected dividend payment is given to preference shareholders over common shareholders.

b. Priority in the return of capital in the event of liquidation is given to preference shareholders over common shareholders.

**Priority in certain expected dividend payment is given to preference shareholders over common shareholders.**

In this case, it is understood that there is possibility that the preference shareholders get 100% of the profit if the actual profit is less or up to the expected profit that is agreed to be given to the preference shareholders. But if the actual profit is more than the said expected profit, there is possibility that the common shareholders get certain ratio of profit. Thus, it seems that the ratio of profit here does not necessarily conform to the ratio of investment. As such, three views of Muslim jurists as mentioned above are applicable here. In other words, according to Imam Malik and Imam Shafi’i this kind of ratio of profit is not permissible. But according to Imam Ahmad, it is permissible. It is also not permissible according to Imam Abu Hanifah since he opines that the ratio of profit of a sleeping partner cannot be more than the ratio of his investment.

By referring to Shari’ah Standards of AAOIFI, it is found that the standards follow the view of Imam Abu Hanifah on the matter. According to article 3 above, the partners may agree to make profit-sharing which does not match their contributions to capital, provided the additional percentage of profit over the percentage of contribution to the capital is not in favour of a sleeping partner. However, the article make an exemption from this ruling by saying: “if a partner did not stipulate a condition that he be a sleeping partner, then he is entitled to stipulate an additional profit share over his percentage of contribution to the capital even if he did not work.”

In summary, a priority in certain expected dividend payment that is given to preference shareholders over common shareholders is permissible according to Imam Ahmad only. It can also be permissible to other Muslim jurists if the preference shareholders do not stipulate a condition that they are sleeping partners only.

**Priority in the return of capital in the event of liquidation is given to preference shareholders over common shareholders.**

This priority is not permissible since the lost must be divided between them exactly in accordance with the ratio of investment as discussed above.

By referring to Shari’ah Standards of AAOIFI also, it is found that the standards follow the view of all Muslim jurists on the matter. According to article 4 above, it is not permitted for the partners to agree on holding one partner or a group of partners liable for the entire loss or liable
for a percentage of loss that does not match their share of ownership in the partnership. However, the article make an exemption from this ruling by saying: “it is, however, valid that one partner takes, without any prior condition, the responsibility of bearing the loss at the time of the loss.”

In summary, a priority in the return of capital in the event of liquidation is given to preference shareholders over common shareholders is not permissible unless one partner takes the responsibility to bear the loss out of his willingness at the time of the loss. Here comes the issue of tanazul that will be discussed below.

**Tanazul**

Based on the explanation given by Shari‘ah resolution of Securities Commission Malaysia (SC), the meaning of tanazul in the context of preference shares is surrendering the rights to a share of the profits based on partnership, by giving priority to preference shareholders. In Islamic jurisprudence, it is also known as isqat haq.

By referring to al-Mawsu‘at al-Kuwaytiyyah as suggested by the above resolution, it is found that isqat haq is closely related to the concept of ibra’ (absolution). Thus, in order to have a clear idea of tanazul, the concept of ibra’ should be discussed.

**Ibra’**

The term ibra’ literally means elimination, release, removal and acquittal from something. In Islamic jurisprudence, the term refers to an act by a person to withdraw his rights from a person who has the obligation to repay the amount borrowed from him. Thus, dropping rights that are not established as a liability on a person (e.g. preemption rights, the right to live in a house that is part of an inheritance) are not considered absolution. They are rather called isqat ma‘īl. In other words, every absolution is a dropping of legal rights, while not every dropping of a legal right qualifies as an absolution.

Even though surrendering the rights to a share of the profits based on partnership, by giving priority to preference shareholders is considered isqat mahd rather than ibra’, yet the discussion of ibra’ is very much relevant here since both are closely related.

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18 Al-Mawsu‘at al-Fiqhiyyah al-Kuwaytiyyah, term ibra’.
Is ibra’ absolution of rights or transfer of ownership?

There is a dispute among the Muslim jurists on the matter. The details of their views are as follows:

The view of the majority (Hanafites, Malikites, a minority of Shafi’ites and most Hanbalites) : It implies absolution.\(^{20}\)

The view of some Shafi’ites and Ibn Muflih of the Hanbali school: It implies transfer of ownership, in some respect.\(^{21}\)

The view of some other Shafi’ites and a group of Hanbalites: It implies transfer of ownership.\(^{22}\)

What can be deduced from the scholars’ views above is that the term *ibra’* covers both meanings: absolution and transfer of ownership; and that one of the two meanings would take precedence in some of the issues and vice versa. It should be noted that in some cases, one of the meanings is specified according to the subject. For example, *ibra’* of goods is considered transfer of ownership, because goods cannot be absolved. However, in the case of debts, the two meanings of *ibra’* are applicable.\(^{23}\)

**The legal effect of the above dispute**

Those who view *ibra’* as an issue of ownership insist on the identification of the object because it is not possible to give away rights of an unknown object. Whereas, for those who view *ibra’* as absolution, such transaction is valid.

As such, for the first group, i.e. the majority of the Muslim jurists, *ibra’* of an unidentified object is valid. In fact, Malikites explain that *ibra’* through a representative is valid even if the rights to the object being released is not identified by the person being represented, the agent and the debtor, because *ibra’* to them, is a gift. Gift of an unidentified object is permissible.

The second group has a similar view with the first group, that *ibra’* is valid even though the object is unknown due to difficulty in identifying it. If it is not difficult to identify the object, the *ibra’* is void. They said *ibra’* is not valid if the person requesting *ibra’* hides something from the owner for fear that the owner will not relinquish his rights should he know the fact.

For the third group, *ibra’* for something not totally identified is invalid. To some of the Shafi’ites, there is no difference whether the ambiguity concerns the type, rate, characteristics, dissolution, deferment or deadline. They explain that if *ibra’* occurs in an exchange such as

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\(^{21}\) Al-Atram. p.297


\(^{23}\) Al-Atram. p.297
khulu’, one stipulation is that both parties can identify and acknowledge the object to the ibra’. In cases other than exchange, it is sufficient that the owner knows and there is no impact if the absolved party is unaware.  

**Conditions of Ibra’**

The conditions of ibra’ may pertain to the mubarrri’ (the party who grants ibra’), the mubarra’ (the party who receives the ibra’), the sighah (offer and acceptance) and the mubarra’ minhu (the subject matter of ibra’). In what follows, each set of conditions is discussed in some detail.

**Conditions of mubarrri’ (the party who grants ibra’)**

The mubarrri’ must satisfy the following conditions:

1. He must be eligible to engage in pure contribution contracts. Thus, he must be sane, of legal age, and discerning, without any legal constraints on his dealings based on mental incompetence of excessive indebtedness. This ruling follows from the fact that ibra’ is a voluntary contribution of the mubarrri’, for which he receives no compensation from the mubarra’.
2. The mubarrri’ must either own the right that he drops thus, or he must be an agent for the mubarrri’.
3. The mubarrri’ must be acting voluntarily of his own volition. Thus, ibra’ by coerced mubarrri’ are deemed invalid.

**Conditions of mubarra’ (the party who receives the ibra’)**

The Hanbali jurists agree that the mubarra’ must be known and identified. Thus, if a creditor absolves “one of his debtors”, without specifying which one, the ibra’ is rendered invalid. Similarly, they ruled that the absolution is invalid if the creditor says: “I have absolved all of my debtors”, unless he means a specific set of debtors or identifies them.

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24 Ibid.
The Shafi’ites also invalidated *ibra’* in which the absolved debtors are not known or properly identified. They based this ruling on the view that *ibra’* involves a transfer of ownership, which is not permissible if the transferee is unknown. Thus, the absolved debtor, to whom ownership is transferred, must be known, whereas the absolving creditor merely drops his right, and thus need not be known.

The Mejelle summarized this condition (item 1567) as follows: “The absolved parties must be known and identified. Thus, if someone says: ‘I have absolved all of my debtors’, or ‘nobody owes me anything anymore’, the absolution is not valid. However, if he says: ‘I have absolved the residents of this location’, where those residents are thus an identified set of individuals, then the absolution is valid”.27

### Conditions of *mubarra’ minhu* (the subject matter of *ibra’*)

The *mubarra’ minhu* must satisfy the following conditions:28

1. The latter Shafi’i doctrine stipulates that the *mubarra’ minhu* must be known. Thus, it is not valid to absolve debts that are unknown in genus, amount, or characteristics, where attaining knowledge thereof is difficult. This ruling follows from the view that absolution is a transfer of ownership, which thus requires consent. In this regard, ignorance of the object of the contract negates the possibility of consent. On the other hand, if a person “absolves another of the silver coins he owes him”, without knowing the size of the debt, the debtor is thus absolved of his liability of three coins, which is the smallest amount for the Arabic plural form can be used.

On the other hand, they said that absolution of unknown debt may be accomplished by absolving the debtor for an amount known to exceed the size of the debt. Thus, if the creditor wishes to absolve his debtor, but does not know whether he owes him RM5 or RM10, he may absolve him of his debt for RM15, thus making sure that the debtor is absolved.

Moreover, they stipulated two exceptions to the prohibition of absolving unknown debts. The first is absolution from a liability for a certain number of camels in retribution for killing a relative. In this case, the liability is unknown in terms of the camels’ characteristics, even though their ages and number is known. In this case, the absolution

is deemed valid, and the characteristics of the camels of the absolved liability are deemed to be the average characteristics in the relevant part of the world. As a second exception, they allowed absolution of unknown debts upon the creditor’s death, since that can be viewed in fact as part of the creditor’s will.

The Hanafites, and Hanbalites disagreed with the Shafi’ites, and allowed absolution of liabilities for goods that are unknown in amount and characteristics, even if it is not difficult to get that information. They based this ruling on the view that absolution is primarily a dropping of the creditor’s right without compensation (in analogy to divorce and freeing of slaves), and thus it can be executed whether or not the object of contract is known. Thus, they consider the absolution valid if a creditor to “absolve his debtor of one of his two debts”, without specifying which one.

However, the Hanbalis stipulated an exception to this rule if the debtor intentionally withholds information regarding the size of his debt, for fear that the creditor may not absolve him if he has that information. In this case, they ruled that the absolution is not valid, since it involves unnecessary deception of the absolving creditor.

2. The mubarra’ minhu must be fungible. This ruling follows from the fact that non-fungibles cannot be established as liabilities, and absolution is a dropping of established liabilities. Thus, if a person usurps a particular book, absolution from this usurpation is not valid. In contrast, liabilities for fungibles or vaguely specified non-fungibles (e.g. camels as retribution for a killing) are valid. Moreover, absolutions from legal rights, such as the right to level a charge, or the right to demand repayment from a guarantor or debt-transferee, are valid.

3. The object of ibra’ must exist at the time of ibra’. Thus, ibra’ from a right prior to its establishment is invalid. For instance, absolving a man from a future debt is not permissible. Consequently, the Hanafites did not allow a wife to absolve her husband from future spending on her needs or from alimony expenses if he were to divorce her in the future. This condition follows from the fact that ibra’ is a dropping of a right, and a right cannot be dropped if it is not established. Proof for this condition was also provided by the hadith: “You cannot divorce someone to whom you are not married, and you cannot free slave that you do not own”.29 Clearly, ibra’ is similar to those contracts in terms of its characterization as a pure dropping of rights.

29 This is a nadÊth asan, narrated by ’AbÊ DÉwÊd, and Al-Êşim. It was also narrated by ’Ibn MÊjah on the authority of Al-Musawwar as: “There is no divorce before marriage and no freeing of a slave prior to owning him”.

15
Conditions of offer and acceptance of *ibra’*

The contract of *ibra’* and its language must satisfy four conditions:

1. The non-Malikites ruled that absolution must be immediately executed, i.e. it cannot be suspended pending a condition, or deferred to a future date. They based this ruling on the view that absolution implies a transfer of ownership, which transfer cannot be suspended pending a condition.

   Thus, if the contract language suspends *ibra’* pending a condition that is in fact satisfied at the time of *ibra’*, the contract is thus executed. Jurists also agreed that the contract is permissible if *ibra’* is suspended pending an admissible condition (e.g. “if you owe me, then you are absolved”, or “if I die, then you are absolved”). They provided proof for the latter ruling by the statement of the Prophet’s companion Abu Al-Yusr to his debtor: “If you can pay your debt, then pay it, otherwise you are absolved”, and his action was not criticized. Thus, the Hanafites allow in absolution of guaranty or debt transfer that the absolving creditor may say: “If you repay me tomorrow, then you are absolved of your guaranty”, whereby the guarantor is absolved if he does bring the repayment on the following day.

   In this regard, the Hanafis and Hanbalis permitted *ibra’* to be suspended pending the creditor’s death, since *ibra’* in this case is tantamount to being part of the will *(wasiyyah)*. In this regard, inclusion of absolution of debt in a person’s will *(wasiyyah)* is permissible. On the other hand, most Hanafites, with few exceptions, did not permit *ibra’* pending other types of conditions merely because they are conventional.

   The non-Malikites ruled that it is not permissible to suspend absolution pending any conditions other than the ones mentioned above. They based this ruling on the view that absolution implies a transfer of property, which transfer cannot be suspended. However, as we have seen, suspension pending a condition is permissible for contracts that involve a pure dropping of a person’s right, with no compensation.

   In contrast, the Malikites allow suspension of absolution pending a condition in all cases. The based this ruling on the view of absolution as a dropping of the creditor’s right.

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2. *Ibra’* should not violate any Islamic law (Syara’). For instance, *ibra’* of the condition of mutual receipt (*al-qabd*) during a currency exchange contract defies Islamic Law, and is thus invalid. Other invalid examples include *ibra’* from the woman’s right to a dwelling during her waiting period after divorce (*iddah*), or *ibra’* of the obligation to act as a small child’s guardian.

Moreover, *ibra’* is rendered invalid if it affects adversely the rights of a third party. For instance, if a divorced mother absolves the husband of her custody rights, the absolution is deemed invalid, since custody rights pertain both to the child and his custodian.

3. The *mubarri’* must have a prior right to the object of *ibra’*. This condition follows from the fact that dealing in the property of others is not permitted except as an agent acting as a proxy for the owner.

4. *Ibra’* must take place after the underlying right is established. This follows from the fact *ibra’* essentially involves dropping an established liability. Thus, jurists have agreed that *ibra’* prior to the establishment of the underlying rights are invalid. Such dropping of right is impossible prior to the establishment of those rights, and thus the absolution is merely a non-binding promise.

If the *ibra’* is issued prior to the establishment of the right, jurists differ on its status after the right is established. The non-Malikites ruled that the *ibra’* is invalid unless it is issued after the establishment of the underlying right. As proof, they relied on the previously cited hadith: “There is no divorce prior to marriage, and no freeing of a slave prior to owning it”, thus reasoning that *ibra’* is similar to those two instances of dropping rights mentioned in the hadith.

The Hanafites thus provided examples of invalid *ibra’* based on the violation of this condition. Those include absolving a husband from his liability for his wife’s expenses before they are estimated, and absolution of the buyer from the price of what he has not yet bought.

The Shafi’ites also gave examples of such premature *ibra’*. For instance, they listed the case of a woman’s *ibra’* of her dowry if her husband died prior to consummating the marriage, and whose marriage dissolution compensation was not determined. They also gave the example of invalid *ibra’* from alimony payments prior to divorce. In both cases, the liability underlying the *ibra’* was not established prior to *ibra’*. 
Another example that they provided pertains to the case where a buyer absolves the seller of his guaranty of the merchandise against perishing prior to its receipt. In this case, the guaranty was non-existent prior to *ibra’*, and hence the *ibra’* is invalidated.

However, they also listed some exceptional cases in which premature *ibra’* can be valid. One such exception is the case of a man who digs a well in another person’s property, and without the owner’s permission. In this case, if the land’s owner absolves him of his transgression and agrees to keep the well, the unauthorized digger of the well is absolved of his responsibility for individuals or animals that may fall in it.

On the other hand, the Malikites had two reported opinions regarding the validity of *ibra’* prior to the establishment of the underlying liability. For instance a woman’s *ibra’* of a future husband of his responsibility for her future expenses is valid according to the preferred view. Another example is the dropping of a preemption right prior to the sale; it is valid according to one view and invalid according to another. They also divided over the *ibra’* for future wounds, and *ibra’* by future heirs of rights to the estate of a terminally ill person to another future heir or a third party for more than one third of the estate.

**Tanazul Analysis**

In light of the discussion above, we now are able to analyze the third Shari‘ah issue in preference share i.e. the priority given is based on *tanazul* which is agreed upon at an annual general meeting of a company. Two issues can be raised here:

1. **The object of *tanazul* is not accurately quantified.**

   Since *tanazul* is agreed upfront or at an annual general meeting of a company, the rate of dividend that is subject to *tanazul* is not accurately quantified. Let say an expected dividend that is given to preference shareholders is 4.5%, we do not know whether it can be achieved or not until the date of distribution. So the *tanazul* could be 100% of profit if the actual dividend is less or up to 4.5% and could be less than that if the actual dividend is above 4.5%. Thus, the object of *tanazul* is not accurately quantified.

   By referring to the issue of *ibra’* as absolution of rights or transfer of ownership, we are able to say that for those who view *ibra’* as an issue of ownership, this *tanazul* is not valid because it is not possible to give away rights of an unknown object. To some of Shafi’ites, there is no difference whether the ambiguity concerns the type, rate, characteristics, dissolution, deferment or deadline. Whereas, for those who view *ibra’* as absolution, this *tanazul* is valid. As such, inability to quantify the object of *tanazul* accurately is not an issue according to the majority of jurists.

2. **Tanazul is given before the underlying right is established.**

   Based on the discussion above, *tanazul* is permissible where it is given on the date of distribution. In other words, *tanazul* must be given after the underlying right is
established. In the context of preference share, it is found that \textit{tanazul} is given upfront or at an annual general meeting whereby the underlying rights i.e. dividend and return of capital in the event of loss are not established yet. Thus, how come the common share holders give up something that they do not own yet? As such, according to the majority of jurists, \textit{tanazul} here is not permissible. Nevertheless, according to one view of Maliki school, it is permissible as mentioned above. Surprisingly, this view is also shared by Abu Hanifah as claimed by Izzuddin Abd Salam in his \textit{al-Qawaid al-Kubra}. He states: “The opinion of Abu Hanifah regarding the following case. A man says to a woman in the presence of the judge, “If I marry you, then you are divorced. Later, he accepts her marriage from the judge by her consent. In this case, the divorce will take place after the marriage, and if she gives birth to a child after six months, it will be attributed to the man….”\textsuperscript{31}

\textbf{Conclusion}

In light of the discussion above, it is appropriate to say that the Shari‘ah resolution given by Securities Commission, Malaysia on the permissibility of preference share is not baseless as assumed by some people. Whether the permissibility is based on the principle of \textit{musharakah} or \textit{tanazul}, there are always the views of scholars or \textit{mazhabs} that can be used to support this resolution. As such, it is appropriate to say that Islamic preference share can be issued either on the basis of the principle of \textit{musharakah} (with a few modifications of the existing Islamic preference share) or the principle of \textit{tanazul}. However, exercising \textit{tanazul} should be done wisely and sensibly; otherwise it can be manipulated to allow fixed or guaranteed profit which is clearly against Shari‘ah law. Fortunately, it is not the case in the context of preference share.